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CITATIONS

Cases:

Continental Assurance Co., Inc. v. *United States* (C. Cls.), decided October 15, 1934, 1934 Prentice-Hall Federal Tax Service, par. 1902 — 9

McCoach v. *Insurance Co. of N. Amer.*, 244 U. S. 585 — 9

Maryland Casualty Co. v. *United States*, 251 U. S. 342 — 9

New York Life Ins. Co. v. *Edwards*, 271 U. S. 109 — 9

United States v. *Boston Insurance Co.*, 269 U. S. 197 — 9

Statutes:

Revenue Act of 1921, c. 136, 42 Stat. 227:
Sec. 245 — 11

Revenue Act of 1924, c. 234, 43 Stat. 253:
Sec. 245 (U. S. C., Title 26, Sec. 1004) — 2

Revenue Act of 1926, c. 27, 44 Stat. 9:
Sec. 245 (U. S. C. App., Title 26, Sec. 1004) — 2

Revenue Act of 1928, c. 852, 45 Stat. 791:
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Revenue Act of 1932, c. 209, 47 Stat. 169:
Sec. 203 (U. S. C. Sup. VII, Title 26, Sec. 203) — 2

Revised Statutes of Utah, 1933, Title 43:
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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

INTER-MOUNTAIN LIFE INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Tenth Circuit entered in the above case on June 25, 1934, affirming a decision of the United States Board of Tax Appeals.

OPINION BELOW

The Board of Tax Appeals rendered no opinion. See Record, p. 30. The opinion of the Circuit Court of Appeals is reported in 71 F. (2d) 962.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 25, 1934. By an order entered

by a Justice of this Court on September 21, 1934, the time for filing a petition for a writ of certiorari was extended for a period of sixty days from September 25, 1934.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts held by respondent, a life insurance company, at the beginning and end of the calendar year 1922, to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons attached to certain insurance-policy contracts denominated "20-Payment Life Coupon Policy—Non-Participating" constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.[1]

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 11–14.

STATEMENT

The facts in the case were stipulated (R. 10–29), and may be summarized as follows:

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[1] Section 245 (a) (2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 261, was reenacted without substantial change in the Revenue Acts of 1924 (c. 234, 43 Stat. 253; U. S. C., Title 26, Sec. 1004) and 1926 (c. 27, 44 Stat. 9; U. S. C. App., Title 26, Sec. 1004); and as Section 203 (a) (2) of the Revenue Acts of 1928 (c. 852, 45 Stat. 791) and 1932 (c. 209, 47 Stat. 169; U. S. C. Sup. VII, Title 26, Sec. 203 (a) (2)).

Respondent is a capital stock life insurance company, organized in the year 1911 under the laws of the State of Utah, and during the year 1922 and prior thereto was engaged in the business of issuing life insurance contracts in Utah, Idaho, and Arizona (R. 11).

Among the policies of life insurance issued by respondent were certain policy contracts denominated "20-Payment Life Coupon Policy—non-participating", each of said policies having nineteen coupons attached thereto, maturing serially on anniversary dates of the policy beginning with the first and ending with the nineteenth (R. 11).

Each coupon is a promise that at its maturity and upon the payment of the premium then due, respondent will pay the amount of the coupon to the owner (R. 11). A specimen copy of such coupon reads on its face (R. 21):

Coupon No. 1 $78.90

INTER-MOUNTAIN LIFE INSURANCE COMPANY
Salt Lake City, Utah
Will pay to the owner of this policy
at its home office
Seventy-eight dollars and 90 cents
Upon presentation of this coupon with
annual premium due
December 1, 1920
Provided all premiums previously due
have been paid
Policy No. *Sample.*

----------,
President.

The reverse side of the coupon reads (R. 22):

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
Payable at death in addition to
the principal sum insured but
RECONVERTIBLE AT ANY TIME
into its cash value.

By the terms of these coupon policies the insured is given certain elections and options respecting such coupons among which it is provided that respondent will credit to the insured the face amount of any matured coupon, as said coupon becomes due, and will pay compound interest thereon at the rate of 3½ per centum per annum, thereby creating a fund to the credit of the insured, which amount may be applied to the payment of premiums or withdrawn in cash at any time by the insured, and if not so applied or withdrawn by the insured prior to his death, the values represented by the coupons, with interest to date of death, will, in the event of the death of the insured while the policy is in force, be paid to the beneficiary, in addition to the face amount of the policy, upon surrender to the respondent of the policy and all coupons issued therewith and unpaid or unmatured prior to the date of said death (R. 11).

Pursuant to the terms of these coupon policies, the insured, at any time during the first policy year or within one month after the due date of the second annual premium, may, in writing, elect to convert the coupons originally attached to such poli-

cies, as such coupons mature, into paid-up life additions to the policy for the amount shown on the reverse side of each coupon, and each coupon must then be surrendered to the respondent within one month after its due date, and payment of the annual premium due on the same date made in full in cash. When the coupon is so surrendered for paid-up additions to the policy and full premium paid, respondent issues to insured a letter of acknowledgment of his remittance and coupon in which it is stated that the amount of the paid-up life insurance has been effected. The paid-up addition to the policy is then only reconvertible into its cash surrender value. (R. 12.)

During the calendar year 1922 respondent paid to holders of matured coupons surrendered during that year the face amounts of such coupons, together with accrued interest thereon in the sum of $897.58. The Commissioner of Internal Revenue, in auditing respondent's income-tax return for 1922, allowed as a deduction the amount of interest paid, i. e., $897.58 on coupons theretofore left to accumulate at interest and surrendered during the tax year 1922. (R. 13.)

Said coupon policies further contained the following (R. 15):

GUARANTEED OPTIONS AT THE END OF TWENTY YEARS

If all the premiums due hereon as stated in the Consideration Paragraph herein are

paid to the Company in full in cash, and if as each coupon attached hereto matures, the amount thereof has been left with the Company to accumulate at interest, then upon the surrender of this policy and all coupons which are attached hereto at date of issue, the Insured shall select one of the following options at the end of twenty years from the date hereof:

1. A Guaranteed Cash Payment of Eight Thousand Dollars.

2. A Paid-up Policy for Life of Fourteen Thousand One Hundred Thirty Dollars, subject to satisfactory evidence of insurability for the excess over the original face amount of this Policy.

3. A Guaranteed Annual Income of Four Hundred Ninety Dollars, to continue for at least Twenty years and as many years thereafter as the Insured shall survive.

4. A Paid-up Policy for Life of Ten Thousand Dollars, without medical reexamination, and an Annual Income of $174.40 Dollars, payable annually thereafter during the life of the Insured.

And the following (R. 16):

Fully Paid-up Benefit: If all of the values represented by the first Fourteen coupons attached to this Policy at issue, are left on deposit with the Company at compound interest as aforesaid, the Company will, upon written request of the Insured hereunder, issue in lieu of this Policy a fully paid-up Policy for Ten Thousand Dollars ($10,000)

> at the end of Fifteen years from the date of this Policy, upon the surrender to the Company of this Policy and all of the coupons originally attached hereto.

On January 1, 1922, the amount of respondent's liability to the holders of *matured, unsurrendered,* and *unpaid coupons,* which had been left with respondent to accumulate at interest (in accordance with one of the options contained in the policies so to do), with accrued compound interest thereon, amounted to the sum of $126,949.03, and at December 31, 1922, to the sum of $146,097.75. The mean of these sums is $136,523.39, and this sum the Commissioner of Internal Revenue refused to include in respondent's "reserve funds required by law" for the year 1922. (R. 12.)

The Board of Tax Appeals sustained the contention of the respondent that the amounts held to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons constituted "reserve funds required by law" within the meaning of the Revenue Act, and the Circuit Court of Appeals denied the Commissioner's petition for review.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a liability which may be converted into life insurance at the option of the insured, but which has not been so converted during the tax year, is one against which a technical in-

surance reserve, such as is contemplated by Section 245 (a) (2) of the Revenue Act of 1921, may be set up and maintained.

2. In holding that amounts which had become unconditionally due and payable during the year 1922 to the holders of matured, unsurrendered, and unpaid coupons, and which had been left during said year with respondent to accumulate at interest, and accrued interest thereon, constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

3. In holding that amounts which had become unconditionally due and payable during the year 1922 to the holders of matured, unsurrendered, and unpaid coupons constituted a contingent liability of the respondent during said year.

4. In failing to hold that amounts which had been left with the respondent during the calendar year 1922, with accrued interest thereon, by the holders of matured, unsurrendered, and unpaid coupons did not constitute "reserve funds required by law" within the meaning of the Revenue Act of 1921, but were merely solvency reserves under the laws of the State of Utah.

5. In holding that the "legal reserves" required to be maintained by respondent during the year 1922 under the laws of the State of Utah included the amounts, with accrued interest thereon, held by respondent to meet its liabilities during said year to the holders of matured, unsurrendered, and unpaid coupons.

6. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below is in direct conflict with the case of *Continental Assurance Co., Inc.* v. *United States,* decided October 15, 1934, in which the Court of Claims, expressly declining to follow the instant case, held that reserves maintained by a life-insurance company to meet its liabilities on matured, unsurrendered, and unpaid coupons attached to policies similar to those involved here were not "reserve funds required by law" within the meaning of the Revenue Acts.[2]

2. It is well settled that the term "reserve funds", as used in the Revenue Acts, has a technical meaning and does not include all reserves maintained pursuant to the requirements of state law or designated as such by state officials. *McCoach* v. *Insurance Co. of North America,* 244 U. S. 585; *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, as modified by *United States* v. *Boston Insurance Co.,* 269 U. S. 197; *New York Life Insurance Co.* v. *Edwards,* 271 U. S. 109, 119. The decision below holds, in effect, that reserves maintained by a life insurance company to meet its liabilities to holders of matured, unsurrendered, and unpaid

[2] The *Continental Assurance Co.* case has not been officially reported, but may be found in 1934 Prentice-Hall Federal Tax Service, par. 1902. For the convenience of the Court, printed copies of the findings of fact and opinion are being filed herewith.

coupons constitute part of the technical insurance reserves contemplated by the taxing Acts. We submit that this is inconsistent with the meaning attributed by this Court to the term "reserve funds" in the cases cited above, and that the decision below is incorrect.

3. The question presented is one of general importance, affecting as it does all life insurance companies issuing policies of life insurance of the type commonly known as "Premium Reduction Coupon Policies." It is important that the conflict of authority be resolved for the guidance of the courts and officers charged with the administration of the law. There are now pending more than fifteen cases involving this issue in the various Circuit Courts of Appeals and District Courts of the United States, as well as several additional appeals now pending before the Board of Tax Appeals.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

NOVEMBER 1934.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 261:

SEC. 245. (a) That in the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

Treasury Regulations 62:

ART. 681. *Reserve funds.*—Under paragraphs (1) and (2) of section 245 (a), life insurance companies are entitled to deduct from gross income: (1) Interest which is exempted in the case of other taxpayers by section 213 (b)(4) and articles 74–83; and (2) the excess, if any, of the reserve deduction specified in section 245 (a)(2) over the amount of such interest. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance. In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Only reserves peculiar to insurance companies are to be taken into consideration. Reserves "maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage" (*Maryland Casualty Co.* v. *United States,* 251 U. S., 342), will not be considered. A company is

permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10, and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19, and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held.

Revised Statutes of Utah, 1933, Title 43:

CHAPTER 3

* * * * *

SEC. 4. *Capital to be Full-paid and Unimpaired.*—No stock company shall do any [life] insurance business in this state before its capital is fully paid up. Said capital must be unimpaired, that is, the assets of such company must equal or exceed all liabilities for losses reported, expenses, taxes and other outstanding *liabilities,* including *the legal reserves* as provided in sections 43–3–12 * * * (L. 21, p. 96, § 1144 [8]). (Italics supplied.)

* * * * *

SEC. 12. *Life Insurance—Valuation of Policies and Reserves.*—For the purpose of making valuations of life insurance policies and of determining the reserves required to be maintained therefor under the provisions of this title *the rate of interest assumed* shall be 3½ percent per annum, and the rate of mortality shall be established by the table known as the "American Experience Table of Mortality" for policies issued after January 1, 1910; * * * (C. L. 17, § 1153). (Italics supplied.)

U. S. GOVERNMENT PRINTING OFFICE: 1934